



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Larry D. Lisenbee

**SUBJECT: MONTHLY FINANCIAL REPORT
FOR JANUARY/FEBRUARY 2007**

DATE: April 5, 2007

Approved

Date

INFORMATION ONLY

The Monthly Financial Report (MFR) for January/February was jointly prepared by the City Manager's Budget Office and the Finance Department and is presented for the City Council's review.

OVERVIEW

Through February, the City's overall financial position continues to be sound. Overall, revenue and expenditures are performing within expected levels and overall economic conditions to date are generally consistent with the assumptions used to develop the 2006-2007 Adopted Budget. In February, the City Council approved the 2006-2007 Mid-Year Budget Review that included many technical adjustments to the current budget as well as a limited number of new items. These adjustments have now been incorporated into the budget.

Following are key highlights in this report:

- Several of the economically sensitive General Fund revenue categories ended 2005-2006 above estimated levels and are on track to meet or exceed the budget estimates for 2006-2007. Collections are also currently on track to meet or exceed budget estimates in many of the non-economically sensitive General Fund revenue categories.
- On March 19, 2007, the State Board of Equalization released Sales Tax data for the second quarter of 2006-2007. This data showed a decrease of just under 1% from the same quarter in the prior year and followed a first quarter that also experienced a decline. Prior to the most recent two quarters, there had been 11 consecutive quarters of Sales Tax growth. While Sales Tax performance has not been positive for the first half of the year, it is still probable that the 2006-2007 budgeted estimate will be met by year-end. This is the case because Sales Tax receipts ended significantly above estimated levels in 2005-2006, and the budgeted estimate for 2006-2007 can be met even if collections do not experience growth for the remainder of the year. The lower collection level will, however, impact the 2007-2008 revenue estimate that had been included in the 2008-2012 General Fund Five-Year Forecast and had assumed stronger Sales Tax performance in this most recent quarter. A downward adjustment to the Sales Tax estimate will, therefore, have to be incorporated into the 2007-2008 Proposed Operating Budget.

OVERVIEW (CONT'D.)

- Expenditures are tracking within estimated levels through February. Cost control measures remain in place, such as the hiring freeze and the technology review process. General Fund savings associated with the departmental “Cost/Position Management Plans” were approved during the 2006-2007 Mid-Year Budget Review for the sixth consecutive year and generated savings of \$4.2 million that were placed in the 2007-2008 Future Deficit Reserve.
- Development-related fee activity and associated revenue continue to track below anticipated levels through February. Staff will closely monitor these activity levels and determine if any budget actions are necessary before year-end.
- The slowdown in the local real estate market remains a concern. This slowdown was, however, anticipated when the 2006-2007 Adopted Budget was developed and estimates for the main impacted revenue categories (Construction and Conveyance Taxes and SB 813 Property Taxes-supplemental taxes associated with property turnovers) were adjusted downward accordingly. As anticipated, actual Construction and Conveyance Tax collections have dropped 17% and the SB 813 Property Tax collections are down 14%.
- The Airport continues to experience sluggish activity levels. Through February, the Airport has enplaned and deplaned 7.0 million passengers, a decrease of 2.6% from the same period last year. There are no signs of imminent improvement. Monthly passenger activity for February, for example, was down 2.4% from February 2006. Year-to-date mail, freight, and cargo totaled 125.1 million pounds, also a decrease of 8.8% from the prior year. February 2007 taxicab operations, however, increased by 8.1% from those in February 2006, and were 7.7% greater than those recorded in 2005-2006.

Economic Environment

When the 2006-2007 Adopted Budget was prepared, it was assumed that the modest but improved level of revenue growth that had been experienced in 2005-2006 would continue for the economically sensitive revenue categories. Revenue growth was also assumed to remain at these moderate levels for the immediate future. While actual collections for the City confirm these basic assumptions, it is a concern that the City’s second largest revenue category, Sales Tax, has not experienced any growth through the first two quarters of the fiscal year.

Job growth has long been considered one of the major elements necessary for renewed economic growth in this region; and employment levels in this area, while far below the peak in the early part of this decade, have started to show improvement. As shown in the chart below, the total employment figure of 905,800 jobs in February was 2.4% above the 884,700 jobs in February 2006 and 4.8% above the 864,000 jobs in February 2005. Between January and February 2007, employment grew by 2,700 jobs.

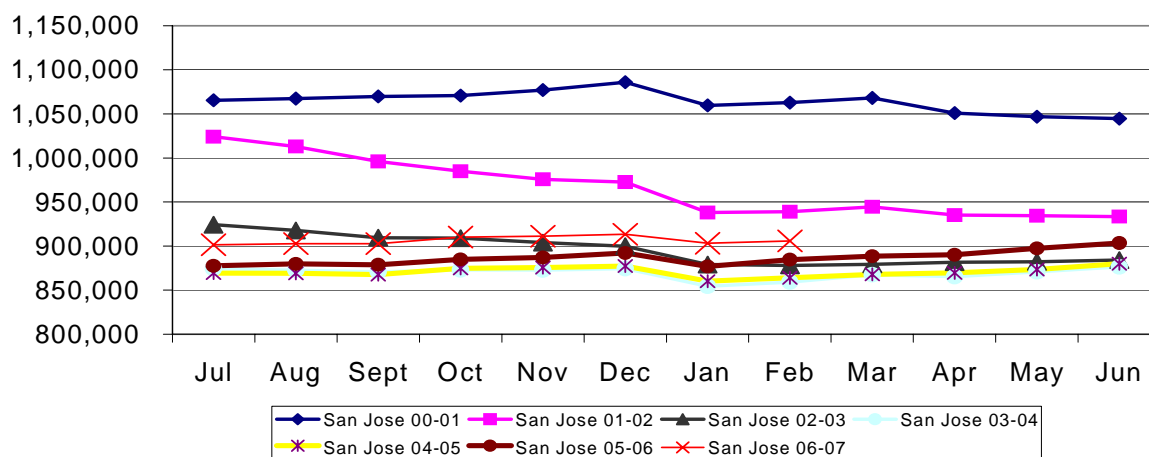
April 5, 2007

Subject: Monthly Financial Report for January/February 2007

Page 3

OVERVIEW (CONT'D.)**Economic Environment (Cont'd.)**

**San José Metropolitan Statistical Area
(Santa Clara County)
Employment: Total Jobs Comparison**



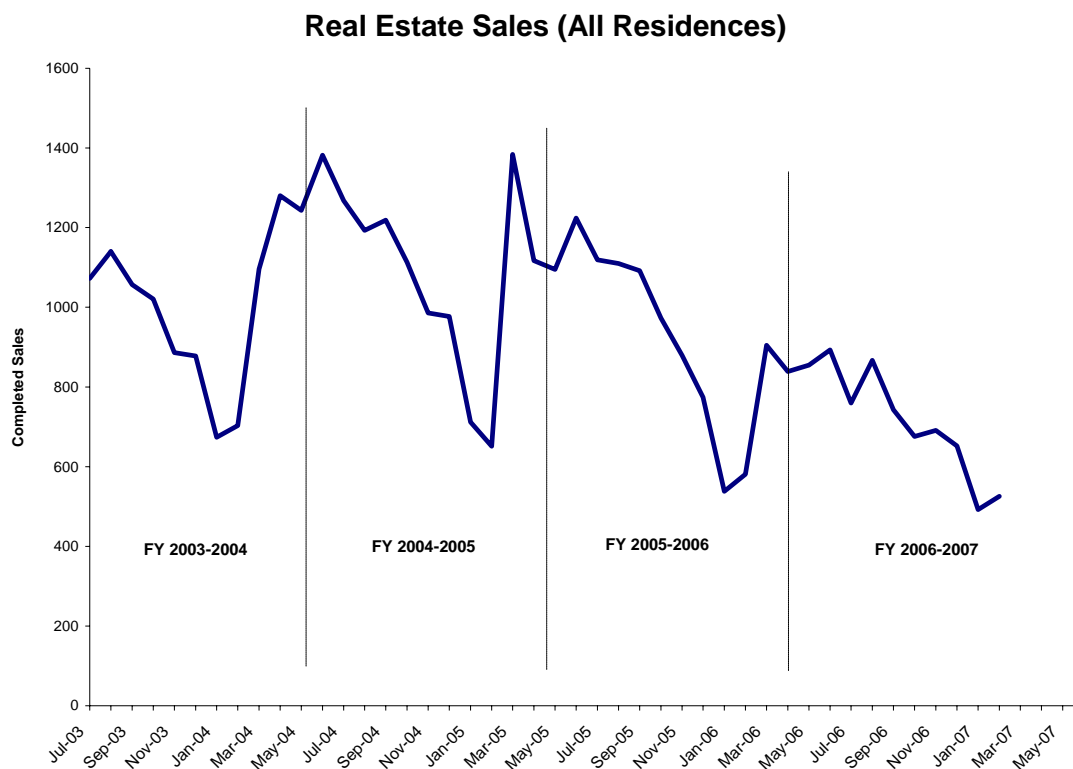
As reported in the San José Mercury News on March 24, 2007, the job growth in the last year included the addition of 6,100 jobs in the professional and business services sectors, continuing a two-year trend of year-over-year job gains. That expansion “is the most exciting and positive part of the news,” said Stephen Levy, director of the Palo Alto-based Center For Continuing Study of the California Economy. “Professional services are where the job growth in the high-tech sector had been for a long time. It was a beginning sign that the high-tech sector overall and the venture capital sector overall was recovering.”

In addition to the gains in the number of jobs, the local unemployment rate remains relatively low. The February unemployment rate for the San José area (unadjusted) was 4.6%, down slightly from 4.7% in January 2007 and below the February 2006 level of 5.0%. The February 2007 results for the San José area were slightly below the unadjusted figures for the State (5.2%) and the nation (4.9%).

While the employment picture remains positive, the cooling housing market is a major concern given its potential to create a drag on economic growth in the near future. The potential extent of this impact has been the subject of many forecasts. In its fourth quarterly report of 2006, UCLA Anderson Forecast economist Ryan Ratcliff predicts that “slowing housing markets will create a significant slowdown in the California Economy, but will not create a recession without a secondary source of weakness.” A significant slowdown in this area would, however, almost certainly negatively impact Sales Tax collections with the downward spending in construction materials and the reduction of consumer spending, as the “wealth effect” associated with housing appreciation diminished. Any major impact on Secured Property Taxes resulting from the current slowdown, however, should not be fully realized until 2007-2008 and 2008-2009, since current year Secured

OVERVIEW (CONT'D.)**Economic Environment (Cont'd.)**

Property Tax receipts are based on the value of property assessed as of January 1, 2006, with adjustments for roll corrections. Since real estate activity was still performing well through calendar year 2005, current year Secured Property Tax receipts are expected to end the year with the predicted level of growth. SB 813 Property Tax collections and Construction and Conveyance Tax revenues, however, have and are expected to continue to drop significantly as the number of property transfers declines. As a sign of the decline in the real estate market, the following chart shows the drop-off in real estate sales experienced during this fiscal year.

**GENERAL FUND REVENUES**

Through February, General Fund revenues totaled \$472.8 million, or 60.6% of the budgeted estimate. This was an increase of \$44.0 million (10.3%) from the February 2006 level of \$428.8 million. Receipts in many categories are outpacing the prior year, including Property Tax, Sales Tax, Utility Tax, Revenue from Local Agencies, Use of Money and Property, and Other Revenues.

Based on year-to-date receipts, there are no indications that the overall 2006-2007 General Fund revenue estimates will not be met. In fact, in light of higher than expected receipts in 2005-2006 and higher current collections trends, our projections indicate that additional revenue above budgeted levels will be received by year-end. The Budget Office will, of course, continue to refine its revenue estimates as additional information becomes available.

GENERAL FUND (CONT'D.)

The following discussion highlights General Fund revenue activities through February.

KEY GENERAL FUND REVENUES

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Property Tax	\$ 183,914,000	\$ 101,501,454	\$ 91,385,698

The Property Tax category consists of Secured Property Tax, Unsecured Property Tax, SB 813 Property Tax (retroactive collections back to the point of sale for reassessment of value due to property resale); and Homeowners Property Tax Relief.

Through February, Secured Property Tax receipts totaled \$87.9 million, or 52.3% of the budgeted estimate of \$167.8 million. The 2006-2007 collections are based on the value of property assessed on January 1, 2006, with any roll corrections. Based on the most current tax roll information provided by the County of Santa Clara, Secured Property Tax receipts are projected to exceed the adopted estimate by approximately \$1.2 million. Tax roll adjustments, however, are still occurring and will continue to take place until the end of May 2007.

In the Unsecured Property Tax category, collections totaled \$9.5 million through February. Almost 90% of the revenue in this category is typically received through October of each year, with the remaining portion received in April. Based on receipts to date, it is anticipated that collections in this category could exceed the budget estimate of \$10.2 million by as much as \$500,000.

The SB 813 Property Tax category generated revenue of \$3.6 million through February, which reflects a decrease of 14% from the \$4.2 million collected through the same period last year. A significant drop-off in this category was, however, anticipated when the 2006-2007 Adopted Budget was developed based on the assumption that real estate sales would slow significantly. Receipts can, in fact, fall 48% from the high of \$10.1 million collected in 2005-2006 and still meet the 2006-2007 budget estimate of \$4.8 million in this category. Because the drop-off in receipts has not been as severe as anticipated when the budget was developed, it is currently projected that proceeds in this category could exceed the budgeted estimate by as much as \$2 million.

In the Homeowners Property Tax Relief category, collections are expected to come in at the budgeted level of \$1.1 million.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Sales Tax	\$ 144,074,000	\$ 75,230,537	\$ 67,518,673

The Sales Tax category includes General Sales Tax and Proposition 172 Sales Tax. General Sales Tax receipts through February of \$72.5 million represented receipts through the first quarter of

GENERAL FUND (CONT'D.)

KEY GENERAL FUND REVENUES (CONT'D.)

Sales Tax (Cont'd.)

2006-2007, two State formula advance payments for the second quarter of 2006-2007, the first payment from the State associated with the “triple flip” calculation, additional funding received in the last quarter of 2005-2006 above the amount accrued for that quarter of \$2.6 million, and the recognition of the remaining balance of \$229,000 from an Aerospace refund from several years ago that has been fully paid. Currently, General Sales Tax receipts are tracking 11.6% above the \$65.0 million received through the same period last year. The higher collection level, however, reflects the accrual adjustment, a higher “triple flip” payment from the State, and higher quarterly advances rather than growth in actual sales tax receipts.

As reported in a prior Monthly Financial Report and the Mid-Year Budget Review, Sales Tax receipts for the first quarter declined 9% from the prior year. This decline, however, was primarily due to a large one-time correction. Factoring out that adjustment, collections were essentially flat for the first quarter. While not reflected in the numbers through February, the Administration has received information on the City’s performance for the second quarter of 2006-2007. Similar to last quarter, collections were very close to the prior year level, with a decline of less than 1% from the same period last year on a cash basis. Staff has also received preliminary information from the City’s Sales Tax consultant, MBIA MuniServices Company, that analyzed this quarter’s performance, adjusted for various one-time items. The data under this type of analysis showed receipts essentially unchanged (up less than 1%) when compared to the same quarter in the prior year. In this analysis, the general retail and food products categories experienced growth of 1.7% and 1.6%, respectively, while the business-to-business, transportation, and miscellaneous categories experienced declines of 2.7%, 0.5%, and 4.7%. Staff will continue to work closely with the City’s Sales Tax consultants to analyze the performance in this quarter once more detailed information is available.

Even though collections have not shown any growth in the first two quarters of this year, it is still anticipated that the 2006-2007 budget estimate will be met or exceeded by year-end. With the strong performance in 2005-2006, the one-time funds available this year associated with the 2005-2006 accrual, and a higher than anticipated payment from the State associated with the “triple-flip”, the budget estimate would still be exceeded even if no growth was experienced for the remainder of the year. While the current year budget estimate should be met, it will be necessary to adjust downward the 2007-2008 revenue estimate included in the 2008-2012 General Fund Five-Year Forecast to reflect the lower than anticipated collection level for the second quarter of 2006-2007. When the Five-Year Forecast was developed, it was assumed that growth of 4% would be realized in the second quarter of 2006-2007. This downward revision will be brought forward as part of the 2007-2008 Proposed Operating Budget.

GENERAL FUND (CONT'D.)**KEY GENERAL FUND REVENUES (CONT'D.)****Sales Tax (Cont'd.)**

As discussed in prior MFRs and the Mid-Year Budget Review, Sales Tax payments continue to be heavily impacted by State actions. In March 2005, voters approved Proposition 57, the California Economic Recovery Bond Act, which allowed the State to purchase bonds to reduce the State budget deficit. One aspect of the bond measure, referred to as the "triple flip", is a very complex set of transactions which involve suspending one-quarter of the Bradley-Burns Sales and Use Tax and replacing the lost revenues with funds set aside from countywide property tax revenues. This change will remain in effect until the State's bond obligations have been satisfied. As a result, the City has been receiving reduced (down 25%) Sales Tax receipts each month. Under the provisions of the State Budget action, the reduced amounts are offset by payments, made twice a year, from property tax receipts (usually in January and May). The City will, however, continue to record the replacement property tax revenues as Sales Tax receipts as the growth formula for these receipts is tied to Sales Tax and this action is considered a temporary situation.

As the payments made by the State in January and May are intended to reflect the entire fiscal year amount, the payments are based on estimates. In September, after the fiscal year ends, the State reviews the actual receipts for the fiscal year and any difference between the estimated payments and the actual amount due is supposed to be trued-up by an addition to, or subtraction from, the next January payment. For San José, the State's calculation of the true-up amount for 2005-2006 resulted in a positive payment to San José of \$870,000. In addition, the State provided information of the two payments it will make in 2006-2007. These payments were higher than originally anticipated when the 2006-2007 budget was developed.

Through February, the Proposition 172 Sales Tax receipts of \$2.8 million are tracking 7.9% above the prior year level. If current collection trends continue, it is anticipated that proceeds in this category will meet or exceed the budget estimate of \$4.4 million by year-end.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Transient Occupancy Tax	\$ 7,600,000	\$ 4,766,647	\$ 4,020,069

Transient Occupancy Tax collections through February of \$4.8 million were above last year's level of \$4.0 million for the same period. With stronger than anticipated performance in 2005-2006 that has continued into 2006-2007, receipts are currently projected to exceed the budgeted estimate by as much as \$600,000. The average room rate increased from \$131.08 in February 2006 to \$137.74 in February 2007, reflecting growth of 5.1% over the prior year. The February 2007 occupancy rate at the 14 major hotels was 67.20%, which was above the January 2007 rate of 57.47% but below the February 2006 rate of 71.89%. While collections have remained strong through the year, the latest monthly year-to-year activity index shows a slight decline of 2% from February 2006, recording the first year-to-year decline in over two years.

GENERAL FUND (CONT'D.)**KEY GENERAL FUND REVENUES (CONT'D.)**

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Franchise Fees	\$ 36,904,000	\$ 19,052,563	\$ 18,048,808

Franchise Fees contains the following categories: Electric, Gas, Commercial Solid Waste, Cable Television, City-Generated Vehicle Tow, Water, and Nitrogen Gas Pipeline. Collections of \$19.1 million from Franchise Fees were tracking above the February 2006 collection level of \$18.0 million. This variance primarily reflects higher collections in the Gas, Cable Television, and Commercial Solid Waste Franchise Fees. It should be noted, however, that the receipts related to Electric and Gas Franchise Fees were actually the result of formula-driven estimated payments from Pacific Gas & Electric (PG&E), based on actual collections in calendar year 2005, and are not necessarily indicative of actual expected receipts. Actual amounts received in 2006-2007 will be based on calendar year 2006 Electric and Gas Franchise Fees. The reconciliation of those amounts will be received in April 2007.

Cable Television Franchise Fees of \$2.9 million reflect two quarterly payments and are tracking 17.8% above the February 2006 collection level of \$2.5 million. If current collection trends continue, receipts are expected to exceed the budgeted estimate of \$5.0 million by at least \$500,000.

Commercial Solid Waste Franchise Fee collections of \$6.69 million are tracking 2.4% above the \$6.53 million collected through February 2006. However, growth of 4.5% is needed to meet the budgeted estimate of \$12.1 million. If the current collection trends continue, receipts in this category would fall slightly below the budgeted estimate.

Collections in the City-Generated Vehicle Tow, Water Franchise Fee, and Nitrogen Gas Pipeline categories are tracking within estimated levels through February.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Utility Tax	\$ 76,098,000	\$ 48,393,349	\$ 45,656,837

Utility Tax includes the following categories: Electric, Gas, Water and Telephone. Utility Tax collections of \$48.4 million were up 6.0% from last year's collection level of \$45.7 million. This was driven by higher collections in the Electric and Telephone categories. A portion of this growth, however, was the result of accounting accrual differences from the prior year.

In the Electric Utility Tax category, collections of \$23.2 million are tracking well above (up 11.8%) the prior year level due both to accrual adjustments and higher current year activity. With growth

GENERAL FUND (CONT'D.)**KEY GENERAL FUND REVENUES (CONT'D.)****Utility Tax (Cont'd.)**

of only 1% necessary to meet the adopted estimate, it is currently projected that receipts will exceed the revenue estimate by at least \$2 million. In the Gas Utility Tax category, receipts of \$5.5 million are tracking 10.3% below the prior year. The 2006-2007 Adopted Budget estimate of \$9.7 million, however, allows for a drop of almost 12% from the \$11.0 collected last year. The projected drop was based on the assumption that the high natural gas costs experienced last year as a result of the disastrous hurricane season would not be experienced again this year. While Gas Utility Tax receipts are currently tracking to meet the budgeted estimate by year-end, collections in this category may be negatively impacted by the 10/20 Plus Winter Gas Savings Program offered by PG&E that will give customers a credit of up to 20% on their March or April bill if they reduce their natural gas usage in January and February.

Collections of \$5.0 million in the Water Utility category are tracking to meet or exceed the budget estimate of \$7.3 million by year-end. Through February, growth of 3.4% over the prior year has been experienced, exceeding the 1% growth needed to meet the budgeted estimate.

Collections in the Telephone Utility Tax category of \$14.7 million are tracking 5.4% above the prior year level of \$13.9 million. Over half of this increase, however, was the result of accrual adjustments from 2005-2006. It is currently anticipated that receipts will come close to the budgeted estimate of \$24.8 million by year-end. To meet this estimate, growth of 6.4% over the actual 2005-2006 receipts is needed. As mentioned in previous MFRs and the Mid-Year Budget Review, there remains a potential for legal challenges associated with the Telephone Utility Tax as a result of the repeal of the federal Excise Tax, from which the City's Telephone Utility Tax was modeled. At this point, the telephone companies have continued to remit the Telephone Utility Tax payments. This issue is being closely monitored by the Attorney's Office, the Finance Department, and the City Manager's Office.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Licenses and Permits	\$ 74,660,399	\$ 51,677,905	\$ 51,421,570

Through February, Licenses and Permits revenue of \$51.7 million tracked slightly above the prior year level of \$51.4 million. Following is a discussion of the major components of this category.

Cardroom Business Tax collections of \$7.3 million were well above the prior year level of \$6.4 million. Based on 2005-2006 collections of \$11.2 million and actual performance through February, this revenue category is expected to significantly exceed the budget estimate of \$9.5 million.

GENERAL FUND (CONT'D.)

KEY GENERAL FUND REVENUES (CONT'D.)

Licenses and Permits (Cont'd.)

Disposal Facility Tax revenue of \$7.9 million through February was tracking 15.5% above the prior year level of \$6.8 million. In 2005-2006, the Alternate Daily Cover exemption was reinstated and Waste Management was reimbursed for the disputed amount they paid the City in 2003-2004, which resulted in a lower payment in 2005-2006. In 2006-2007, collections are tracking to meet the budgeted estimate of \$14.7 million by year-end.

In the Business Tax category, collections of \$12.3 million through February were tracking above the prior year level of \$11.5 million and are expected to exceed the budgeted estimate of \$12 million by approximately \$1 million. The higher collection level is the result of the Business Tax Amnesty Program, which ran from August 2, 2006 through September 29, 2006.

Fire Permit collections through February of \$4.1 million were 20% below the prior year level of \$5.1 million, primarily due to an amount (\$703,000) included in 2005-2006, which should have been deferred to 2006-2007. As a result, Annual Renewable Permits are expected to end the year significantly below the estimated levels. Normalizing for this error, actual Fire Permit revenues are still tracking 6.3% below actual prior year receipts due to lower than anticipated receipts related to development activities, including Non-Renewable Permits and Plan Check. Development-related collections are 10% below levels received through February 2006. The 2006-2007 budget estimate, however, allows for only a 5% drop from the 2005-2006 actual receipts. Collections may improve at the end of the year as there are a number of high-rise projects that may move forward in spring 2007 that could generate a significant amount of fee revenue.

Building Permit revenues of \$14.2 million were also tracking below both budgeted levels and last year's collection level of \$15.9 million. Overall, the revenue projection for 2006-2007 was based on the assumption that activity would remain close to 2005-2006 levels with a net fee reduction of 1%. However, since actual collections in 2005-2006 of \$24.0 million fell slightly below anticipated levels, slight growth is needed in 2006-2007 to meet the budget estimate of \$24.3 million. In February, residential activity was slow and commercial activity was moderate. Groundbreaking occurred on a 24-story high rise (ultimately including 213 units) and a 34-unit single family detached project. Permits were also issued at The Plant Shopping Center (the old GE site). No new industrial construction permits were issued. Overall, revenues could end the year below the budgeted estimate by as much as \$1 million. In this program, any revenue shortfall could be offset by the use of the fee reserve and expenditure savings.

The development-related revenues will be closely monitored to determine whether budget actions will be necessary during the year.

GENERAL FUND (CONT'D.)**KEY GENERAL FUND REVENUES (CONT'D.)**

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Fines, Forfeitures and Penalties	\$ 12,536,567	\$ 9,443,039	\$ 9,032,099

This category includes parking fines, the City's share of vehicle code fines, administrative citation fines and penalties, and cardroom and business tax penalties. Through February, collections of \$9.4 million are tracking above both the prior year collection level and the budgeted estimate. Based on receipts to date and the prior year collection patterns, revenue in this category should exceed the budgeted estimate of \$12.5 million by at least \$2 million. In this category, an outstanding fine payment from the Garden City card club of \$500,000 was received in March. Beginning in April, additional monthly payments will be received over a 28-month period to complete the fine payment that has been outstanding for several years due to bankruptcy proceedings. In 2006-2007, these monthly payments will result in an additional \$135,000 in fine revenue.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Use of Money and Property	\$ 10,845,781	\$ 9,220,648	\$ 6,032,256

Use of Money and Property revenue collections of \$9.2 million through February were well above the prior year level of \$6.0 million, reflecting higher than anticipated interest rates and investment earnings. If the current rate of earnings continues, it is expected that this category will significantly exceed the budgeted estimate by year-end. This reflects a combination of higher interest rates and higher cash balances in the various funds in which interest earnings are credited to the General Fund.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Revenue from Local Agencies	\$ 47,140,549	\$ 35,116,860	\$ 24,402,479

This category includes reimbursement from the San José Redevelopment Agency for City services, grants from various agencies, reimbursement for fire suppression services in unincorporated County pockets, and reimbursement for emergency medical services. Revenue from Local Agencies of \$35.1 million through February was well above the prior year level of \$24.4 million. This variance was, however, primarily the result of differences in the timing of payments from the San José Redevelopment Agency. Revenue from the Central Fire District of \$4.3 million is also currently tracking above the prior year level of \$3.0 million and is projected to exceed the budgeted estimate of \$5.6 million by at least \$500,000. Overall, revenues in this category are expected to end the year close to the adopted estimate.

GENERAL FUND (CONT'D.)**KEY GENERAL FUND REVENUES (CONT'D.)**

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Revenue from the State of California	\$ 10,446,294	\$ 9,522,166	\$ 7,220,019

Revenues from the State of California of \$9.5 million through February were 31.9% above prior year collections of \$7.2 million. The higher collection level reflects higher Motor Vehicle and Airplane In-Lieu payments along with higher grant payments. The Motor Vehicle In-Lieu payments of \$4.2 million are tracking above estimates due, primarily, to one-time payments from the State associated with prior year collections in 2004-2005 and 2005-2006 that totaled \$739,000. Collections in this area are expected to exceed the budget estimate by at least \$1 million by year-end. Airplane In-Lieu payments of \$2.1 million through February have already exceeded the budgeted estimate of \$1.0 million. Based on historical collection patterns, receipts in this area are expected to exceed the budgeted estimate by almost \$1.4 million by year-end. With the exception of the Public Library Grant, grant funds are projected to meet the budgeted estimates. The actual Public Library Grant revenue of \$551,000 exceeded the budgeted estimate of \$316,000.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Departmental Charges	\$ 29,661,288	\$ 18,771,378	\$ 17,735,337

The Departmental Charges category is tracking close to the budgeted estimate through February. This is the result of higher than anticipated collections in the Transportation and Miscellaneous Departmental Charges categories, offset by lower receipts in the Planning and Public Works Fee Programs. The Library, Police, and Parks, Recreation and Neighborhood Services fees are tracking within estimated levels.

Following is a discussion of the two major development-related fee areas in this category.

Public Works revenues of \$4.5 million were 1.1% above the prior year level. This increase, however, is well below the level necessary to meet the 7.2% growth rate included in the adopted revenue estimate of \$7.9 million. While collections are currently tracking below estimated levels, the Public Works Department anticipates receiving a large payment from Hitachi that will bring the revenues closer in line with the budgeted estimate. The Budget Office will continue to work with the Department to determine whether adjustments to revenues and expenditures will be necessary before year-end.

Planning Permit revenue of \$3.3 million through February also tracked below (down 5.3%) the prior year collection level of \$3.5 million and approximately 13% below anticipated levels. Based on current collection trends, receipts may end the year as much as \$500,000 below the budgeted

GENERAL FUND (CONT'D.)**KEY GENERAL FUND REVENUES (CONT'D.)****Departmental Charges (Cont'd.)**

estimate of \$6.2 million. The Budget Office will continue to work with the Department to project the year-end collection level, bringing forward appropriate adjustments, if necessary, as more information becomes available. The Planning, Building, and Code Enforcement Department is currently planning to keep existing vacancies until activity levels improve. Any expenditure savings would be available to offset the lower revenue collection level.

<u>Revenue</u>	<u>2006-2007 Estimate</u>	<u>YTD Actual</u>	<u>Prior YTD Collections</u>
Transfers and Reimbursements	\$ 100,909,642	\$ 67,201,677	\$ 71,017,118

This category includes overhead reimbursements from operating and capital funds, transfers, and other reimbursements. Transfers and Reimbursement collections of \$67.2 million through February were 5.4% below the prior year level of \$71.0 million. The lower collection level reflects the timing of transfer payments as well as the differences in the amount budgeted for transfers in 2006-2007. Overall, collections in the Transfers and Reimbursements category are expected to meet or slightly exceed budgeted estimates by year-end based on higher capital overhead reimbursements.

Overhead reimbursements for operating funds will be received at the budgeted levels. During the Mid-Year Budget Review, adjustments were made to the overhead reimbursement amounts based on the final City-wide overhead rates released by the Finance Department. Additional adjustments will be brought forward at year-end based on the final grant overhead rates that will result in a slight downward adjustment of approximately \$100,000.

The capital overhead reimbursements are received based on actual capital expenditures. These reimbursements are currently tracking above anticipated levels based primarily on an increase in the capital overhead rate. Collections in this area are currently projected to exceed the budget estimate by year-end.

CASH

General Fund Cash balance at the end of February of \$214.6 million was above the \$186.5 million balance achieved at the end of February 2006. In February 2007, revenues totaled \$47.0 million while expenditures totaled \$57.2 million, for a net reduction in the cash balance of \$10.2 million from the January 2007 cash balance. Staff will continue to closely monitor the status of cash balances in the General Fund and report to the Council as part of these reports.

GENERAL FUND (CONT'D.)**EXPENDITURES**

Through February, General Fund expenditures of \$480.0 million were 13.9% above (up \$58.4 million) the prior year level of \$421.6 million. Encumbrances of \$37.6 million were 16.0% above (\$5.2 million) the prior year level of \$32.4 million. Expenditures and encumbrances (\$517.5 million) through February constitute 58.1% of the total 2006-2007 revised budgeted uses of funds (\$890.2 million, excluding reserves). On an overall basis, cumulative departmental and non-departmental expenditures appear to be within or below approved budgeted levels through February.

The following discussion highlights significant General Fund expenditure activities through February:

KEY GENERAL FUND EXPENDITURES

<u>Department</u>	<u>2006-2007 Budget</u>	<u>YTD Actual</u>	<u>Prior YTD Actual</u>
Police	\$ 263,211,839	\$ 155,185,298	\$ 145,341,673

On an overall basis, the Police Department expenditures are tracking close to estimated levels. Personal Services expenditures of \$147.1 million tracked close to anticipated levels (60.9% of the budget compared to the estimated level of 61.5%) as the Department continues to use vacancy savings to fund overstrength positions for the Sworn Recruitment and Training Program. With the addition of \$1.6 million to the overtime budget for "Orange Alert" staffing that was approved as part of the Mid-Year Budget Review, overtime expenditures through February tracked below anticipated levels at \$5.1 million or 53.7% of the budgeted level compared to the estimated level of 61.5%. Overtime expenditures through February related to the increased security threat level total \$879,000. At this time, it is anticipated that the Police Department will end the year within its Personal Services allocation. The Budget Office and Police Department will continue to monitor Personal Services to ensure expenditures are within approved appropriations by year-end.

In the Sworn Recruitment and Training Program, the Department graduated 34 Police recruits from the July 2006 Academy, with officers expected to be street-ready in April 2007. In addition, the Department hired 50 Police recruits for its January 2007 Recruit Academy, with officers expected to be street-ready in October 2007. The Department has also hired or rehired 16 lateral Officers since the beginning of the fiscal year.

The compensatory time balance at the end of February 2007 was 220,805 hours for sworn personnel. This represents a 2,784 hour increase (1.3%) compared to the January 2007 balance of 218,021, however a 14,166 hour increase (6.9%) compared to the February 2006 balance of 206,639. A number of factors are leading to the increase in sworn compensatory time balances, including responses to specific types of crimes such as homicides which require immediate and intensive investigations, and the need to backfill for street-ready vacancies. The Department's sworn

GENERAL FUND (CONT'D.)**KEY GENERAL FUND EXPENDITURES (CONT'D.)****Police Department (Cont'd.)**

compensatory time reduction program for personnel with balances over 240 hours as of December 30, 2006 is expected to limit compensatory time growth for the next quarter. A rebudget of overtime funds approved as part of the 2005-2006 Annual Report as well as an appropriation of overtime funds at Mid-Year should enable the Police Department to contain compensatory time growth in the current fiscal year. Staff will continue to monitor this balance.

A total of 51.4% of the Department's Non-Personal/Equipment budget was expended or encumbered through February. The majority of Non-Personal savings are related to vehicle maintenance and operation and vehicle replacement. It is estimated that the Department will end the year within its Non-Personal/Equipment allocation.

<u>Department</u>	<u>2006-2007 Budget</u>	<u>YTD Actual</u>	<u>Prior YTD Actual</u>
Fire	\$ 129,559,162	\$ 78,322,939	\$ 77,374,705

Overall, expenditures for the Fire Department were tracking within estimated levels through February (60.4% expended).

Through February, Personal Services expenditures of \$74.4 million tracked approximately at estimated levels (60.7% expended versus a par level of 61.5%). Salary and benefit expenditures tracked above par level while overtime expenditures tracked at lower than estimated levels (50.9% expended). The lower overtime expenditure level is due to various budgeted overtime activities (such as the third Firefighter Recruit Academy and the Fire Engineer Academy) that have not yet occurred. At this time, the Fire Department expects that overtime expenditures at year-end will be lower than budgeted. Savings in this category are, however, expected to offset projected higher expenditures in salaries and benefits with the April Firefighter Recruit Academy. On an overall basis, the Fire Department currently anticipates ending the year within the budgeted allocation for Personal Services expenditures. The Fire Department and Manager's Budget Office will continue to monitor Personal Services expenses closely and make adjustments if necessary.

Through February, the Fire Department had a total of 250 filled paramedics (158 front-line, 4 Supervisors, and 88 support). When compared to the 147 front-line medics that are necessary to fully staff all apparatus, this represents the highest level of filled paramedics in the Department's history. Of the 25 Firefighters that graduated from the April 2006 Academy in August, 24 completed their paramedic accreditation through February. In order to maintain the appropriate staffing levels necessary, a 17-week Firefighter/Paramedic Academy consisting of 29 recruits began in January 2007. The Department projects it will have no problem maintaining the target staffing level of 147 primary Firefighter Paramedics.

GENERAL FUND (CONT'D.)

KEY GENERAL FUND EXPENDITURES (CONT'D.)

Fire Department (Cont'd.)

The Department's Non-Personal/Equipment budget of \$7.1 million was 72.1% expended or encumbered through February. The Non-Personal/Equipment budget is expected to end the year within the budgeted allocation.

CONTINGENCY RESERVE

Through February, the General Fund Contingency Reserve was at \$28,039,462, up by \$1,034,462 from the 2006-2007 Adopted Budget level of \$27,005,000. The following revisions to the Contingency Reserve were approved through October:

- A decrease of \$15,000 to increase funding for the City of San José Volunteer Celebration.
- A decrease of \$100,000 to establish an appropriation for the Greater Terrace Drive Soil Testing Project.
- An increase of \$1,149,462 to bring the Contingency Reserve to 3% of the budget based on the Annual Report actions.

OTHER FUNDS

Construction and Conveyance Tax Funds

As anticipated, Construction and Conveyance (C&C) Tax revenues are continuing to decline due to the slowdown in the local real estate market. Collections through February totaled \$25.1 million, down 16.9% from the \$30.2 million collected through February 2006. In addition to these revenues, the City has since received March Conveyance Tax receipts totaling \$2.3 million. This amount is 14.8% lower than the March 2006 amount of \$2.7 million. For nine out of the last ten months, the current year monthly Conveyance receipt is lower than the prior year receipt, due primarily to the drop in the number of property transfers (sales). While collections have dropped since the beginning of the year, receipts are still performing strong enough to exceed the current year budget estimate. For purposes of developing the 2007-2008 Proposed Capital Budget, it is assumed that 2006-2007 receipts will at least reach \$34 million, an increase from the \$27 million included in the Adopted Budget. This will still allow collections to decline 31% from the high of \$49 million received in 2005-2006.

Construction and Conveyance Taxes are almost entirely generated from property transfers. As of February, the number of property transfers for all types of residences has decreased by approximately 23% from the prior year. While the number of transactions is down, the median home price has surprisingly not yet dropped. The median home price in February 2007 was \$715,000, compared to the February 2006 figure of \$710,000. However, it should be noted that the amount of time it took to sell these homes has grown tremendously. The average days-on-market was 75 days in February 2007, which is 67% longer than the average of 45 days in February 2006.

OTHER FUNDS (CONT'D.)**Other Construction-Related Revenues**

Through February, permit valuation for residential, commercial, and industrial construction activity are above prior year levels. Residential activity was slow with the construction of 121 units in February. Groundbreaking occurred on *Three Sixty Residences*, a 24-story high-rise project located on the northeast corner of South Market and West San Salvador Streets adjacent to the landmark California Theater. The project includes 213 units and 11,200 square feet of retail space. Groundbreaking also occurred on *Hawthorn Place II*, a 34-unit single-family detached project by Taylor Woodrow Homes located on the south side of Rock Avenue, west of Oakland Road. This is one of four projects by this developer in the vicinity, including the recently completed *Hawthorn Place* project next door and two townhome projects across the street along Oakland Road. Commercial activity remained moderate at \$24.7 million. Additional permits were issued at *The Plant Shopping Center* (northwest corner of Curtner Avenue and Monterey Road), which broke ground last month. The latest permits were for three buildings, totaling 75,000 square feet, at the southwest corner of the site. No new industrial construction permits were issued. Ceremonial groundbreaking occurred at *Cadence Design Systems* for a 208,000-square foot building at the company's headquarters on the northerly corner of Montague Expressway and Trimble Road. This permit activity drives the revenue collection in several categories, including the Construction Excise Tax, the Building and Structure Construction Tax, and the Residential Construction Tax, and is an indicator of future activity for several other categories, such as the Storm Drainage and Sanitary Sewer System fees.

Through February, actual receipts for the seven revenue sources monitored for this report totaled \$19.8 million, which represented an increase of 21.0% from the \$16.3 million collected through the same period last year and which were well above budgeted estimates. The major revenue sources – Building and Structure Construction Taxes and Construction Excise Taxes – outperformed year-to-date estimates and also tracked higher than in 2005-2006. Building and Structure Tax receipts through February totaled \$7.7 million, which is 79.1% of the 2006-2007 estimated level of \$9.7 million. This represents an increase of 27.6% from the revenues collected through the same period last year (\$6.0 million). To meet the budgeted estimate, no growth is needed in 2006-2007. Construction Excise Tax revenues through February totaled \$10.7 million (78.2% of the current 2006-2007 estimate of \$13.7 million), which represents a 25.3% increase from last year's \$8.6 million received over the same period. The budgeted estimate for this category allows for a 2.7% drop in 2006-2007.

Other construction-related revenues are generated through Residential Construction Taxes, Municipal Water Service Connection Fees, Municipal Water Major Facilities Fees, Sanitary Sewer Fees, and Storm Drain Fees. Residential Construction Taxes are currently tracking above prior year actuals and are within the budgeted estimate for 2006-2007. Residential Construction Taxes totaled \$237,000 (94.9% of the current 2006-2007 estimate of \$250,000), which represents a 30.3% increase from last year's \$182,000 collected over the same period. Sanitary Sewer Fees, Municipal Water Service Connection Fees, Municipal Water Major Facilities Fees, and Storm Drain Fees, however, are all tracking below prior year levels and Staff will continue to monitor these revenues closely. Because Municipal Water Service Connection Fee and Major Facilities Fee revenues recover actual costs to install new services, a lower collection level is coupled with lower costs.

April 5, 2007

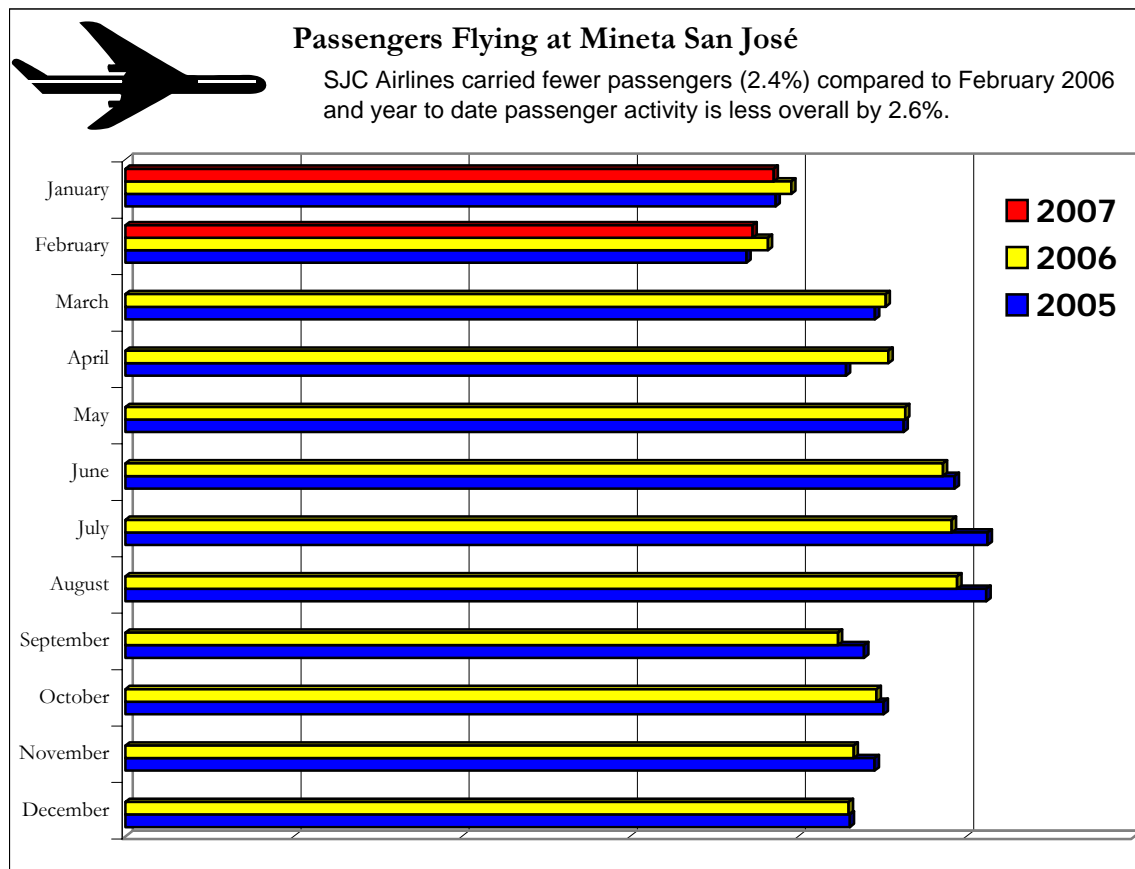
Subject: Monthly Financial Report for January/February 2007

Page 18

OTHER FUNDS (CONT'D.)**Airport Activity**

As mentioned in the overview, activity at the Airport continues to be down (although within budgeted levels) with no signs of imminent improvement. On a fiscal year-to-date basis, the Norman Y. Mineta San José International Airport (SJC) has enplaned and deplaned 7.0 million passengers, a decrease of 2.6% from the figures reported through February of the prior year. Monthly passenger activity for February was down 2.4% from February 2006.

Terminal C passenger activity for February 2007 decreased 6.8% and year-to-date activity was down by 6.6%. Terminal A activity increased 0.3% in February-to-February comparisons and is 0.1% greater than the year-to-date figure reported through February 2006. Fiscal year-to-date mail, freight, and cargo totaled 125.1 million pounds, which represents an 8.8% decrease from 2005-2006. February 2007 taxicab operations increased by 8.1% from those in February 2006, and were 7.7% greater than those recorded in 2005-2006. Year-to-date Passenger Facility Charge (PFC) revenues were 2.0% less than the previous fiscal year.



OTHER FUNDS (CONT'D.)

Airport Activity (Cont'd.)

Airport Revenues

Performance results were mixed across all revenue categories but on an overall basis, year-to-date operating revenues of \$75.0 million through February 2007 inched 1.5% above projections. Landing fees were tracking on target with the budget estimate and the rest of the revenue categories, except terminal rentals and parking and roadway, which performed ahead of the forecast.

Year-to-date revenues from the Airport Customer Facilities and Transportation Fee Fund totaled \$2.2 million and reflect a 2.7% decline in rental car activity from last year.

Airport Expenditures

Through February, Airport Maintenance and Operations Fund expenditures tracked below the estimated budget levels in both Personal Services and Non-Personal/Equipment. Personal Services expenditures were 58.7% of budget compared to the benchmark of 61.5%, with savings attributed primarily to vacancies. Through February the department carried 51.2 vacancies or a 13.3% vacancy rate. Over the last twelve months, there have been at least 44.0 vacant positions at the close of each month. Mid-year adjustments for the salary program and the department's \$4.8 million Cost/Position Management Plan have been included in this expenditure analysis.

Non-personal/Equipment expenditures were 43.7% of budget compared to the benchmark of 58.4%. While the overhead rate was adjusted from an estimated 25.64% to 15.95% at mid-year and the savings resulting from the reduced overhead rate have been included in the Cost/Position Management Plan, the overhead funds had not yet been transferred to the General Fund through February. With the finalization of the overhead charge, it is anticipated that the majority of this cost will be reflected in March. Encumbrances totaled \$11.8 million, bringing total Non-Personal/Equipment commitments to \$29.1 million or 73.6% of budget.

Expenditures in the Airport Customer Facilities and Transportation Fee Fund totaled approximately \$2.8 million, 13.4% less than anticipated through February. Six shuttle buses have been returned to the lessor and removed from the lease, which will result in reduced costs over the remainder of the year.

In summary, although activity levels at the Airport are below both 2005-2006 levels and 2006-2007 growth projections, the Airport's current fiscal situation is stable. Due to conservative estimates, revenues are slightly higher than projected, and due to a higher number of vacancies, Personal Services expenditures are tracking significantly below budgeted levels.

OTHER FUNDS (CONT'D.)

Public Works Program Support Fund

The Public Works Program Support Fund accounts for the administrative services and staff absences associated with the Public Works Department. These costs are reimbursed by the various capital funds. Through February, revenues of \$6.7 million are tracking well below expenditures of \$9.2 million. Because there is a one-month lag in the booking of revenues, the actual variance between revenues and expenditures is a lower, although still significant, amount of \$1.8 million. The gap between revenues and expenditures has actually grown in the last couple of months due in part to the timing of reimbursements associated with compensated absences. The Personal Services expenditures in the Public Works Department are also tracking above expected levels through February. The Department is working on a cost reduction strategy to bring expenditures in line with budget. In addition, the charges to the various capital funds/projects will be adjusted upward, if necessary, to ensure that sufficient revenue is collected to offset costs. The Manager's Budget Office will continue to closely monitor performance in this fund.

Transient Occupancy Tax Fund

Transient Occupancy Tax (TOT) collections of \$7.2 million through February were above both prior year collection and budgeted levels. If this trend continues, revenue could end the year 10-15% above the budget. As described earlier for General Fund Transient Occupancy Tax collections, the average room rate increased from \$131.08 in February 2006 to \$137.74 in February 2007, while the overall number of available rooms remained stable. The February 2007 occupancy rate at the 14 major hotels was 67.20%, which was above the January 2007 rate of 57.47% but below the February 2006 rate of 71.89%. While collections have remained strong through the year, the latest monthly activity data shows a slight decline of 2% from February 2006, recording the first drop in over two years.

CONCLUSION

Through February, the City's finances remain in sound condition, with revenues generally tracking at or above estimated levels and expenditures remaining within budgeted estimates. In the General Fund, revenues are currently projected to exceed the budgeted estimates while expenditures are expected to remain within budget. The higher revenue collections are spread among many of the revenue categories rather than concentrated in one or two areas. This higher collection level was factored into the development of the 2008-2012 General Fund Five-Year Forecast that was released at the end of February. It was assumed that a combination of excess revenues, expenditure savings, and the liquidation of carryover encumbrances would result in additional fund balance at the end of 2006-2007 of \$25 million. It is still anticipated that at least this level of fund balance will be available at the end of the fiscal year for use in 2007-2008.

While the City's overall financial performance remains positive, concerns remain in the areas of Sales Tax growth and the slowing housing market. The lack of Sales Tax growth in the first two quarters of this fiscal year point to lower economic growth than originally anticipated when the 2006-2007

April 5, 2007

Subject: Monthly Financial Report for January/February 2007

Page 21

CONCLUSION (CONT'D.)

budget was developed. While it is still anticipated that the 2006-2007 Sales Tax revenue estimate will be met, the lower collection rate will need to be factored into the development of the 2007-2008 Proposed Operating Budget. In addition, a slowdown in the housing market will likely have a direct future impact on a number of the City's revenue sources, including Property Taxes and Construction and Conveyance Taxes, as well as indirect impacts on other significant revenue categories such as Sales Tax. Construction and Conveyance Tax receipts that are based on property transfers, for example, have dropped by 17% when compared to last year. The SB 813 Property Tax receipts are also tracking 14% below the prior year. The impacts to most of these categories were, however, anticipated in the development of the 2006-2007 Adopted Budget.

As always, staff will continue to closely monitor our current year financial status and report to the City Council any and all significant developments through this reporting process.

/s/

LARRY D. LISENBEE

Budget Director